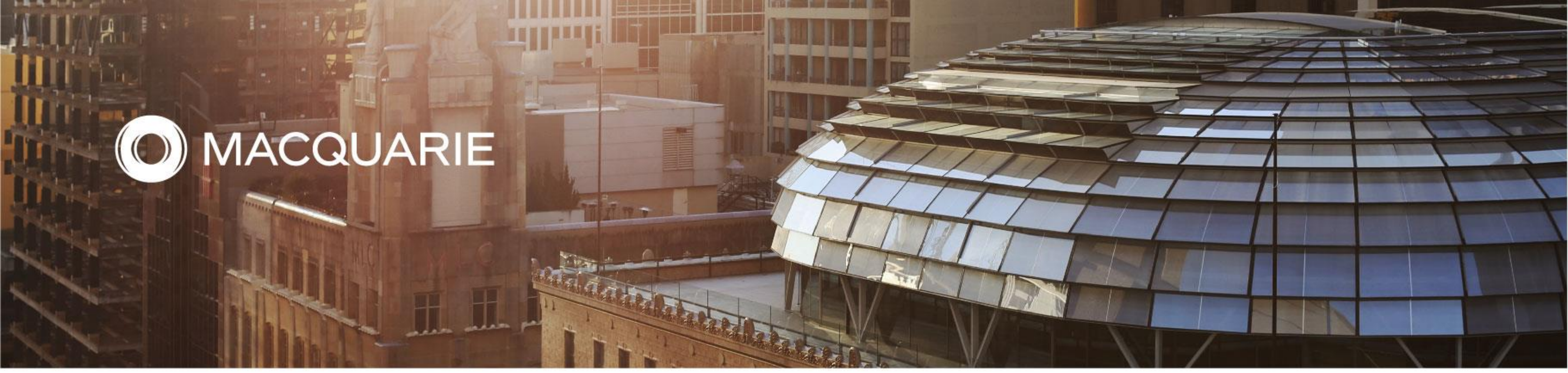


Investment Strategy Update #120

Alternative real estate: A new growth option in real assets

- Alternative real estate is a fast-growing sub-category within the broader real estate asset class and can be defined as any areas outside of the 'traditional' office, retail and industrial classifications. The potential for higher returns and the lower correlations of this area will continue to see it grow in size and appeal where it already makes up more than 50% of the US REIT universe.

- Demand for alternative real estate is being driven by both cyclical and structural forces, with the latter including: 1) The digital economy; 2) Demographics; 3) Urbanisation; 4): Falling home ownership; and 5): Increased workforce participation.

- Alternative real estate is a growing share of the allocation to real estate given its potential to raise the risk adjusted return of the subcomponent of the real asset allocation. While this is a relatively new area of investment, returns have been stronger than traditional real estate (11.0% vs 6.5% per annum) and with the added benefit of lower correlation to traditional equites (68% vs. 83%). Additionally, alternative real estate has outperformed traditional real estate year-to-date during this year's selloff (-21.4% vs, -28.3%).

- As with traditional real estate, alternative real estate can be invested via funds or listed stocks (i.e., REITs). In Australia, investment options are limited, and it remains hard to get pure exposure (other than via taking on individual direct asset risk).

- Going forward, we expect investors will increasingly add alternative RE to traditional allocations – if not raise exposure levels given superior risk adjusted returns. For now, we think the trend will be towards single direct investment options which may not be suitable for all investors, but the growth of this investment option in the US suggests it will not be long before investors have a much broader sub-set of investment options.

What is alternative real estate?

Alternative real estate is any sector that does not fall under the traditional as areas of office, retail and industrial.

Key alternative sectors include:

1. **Build-to-rent**: Sometimes referred to as "multi-family housing", this sector is relatively new to Australia but well established overseas (& considered a 'traditional' sector). Build-to-rent apartment buildings are built with the intention that the developer (or a (usually institutional) investor) will own the building for the purpose of renting out the apartments to tenants, rather than selling those apartments off.
2. **Self-storage**: Facilities that provide rented storage space to individuals and business on a 'short-term' (i.e., usually monthly) basis.
3. **Data centres**: Property used to house information technology systems.
4. **Medical office & life sciences**: Medical offices are real estate developed specifically for medical professionals to consult with patients and perform various surgical procedures. Life sciences are facilities that house activities relating to biotechnology, pharmaceuticals and medical devices (e.g., laboratories).
5. **Hotels & Pubs**: Hotels are property that is operated as a hotel, motel or other lodging for transient use of rooms. Although a long-established sector, some may consider it to be non-traditional. Pubs are a growing asset class as the previously largely family-owned sector becomes institutionalised.
6. **Student housing & senior accommodation**: Student accommodation is property specifically designed for long-term stay by students of an educational facility. Senior accommodation is housing that is suitable for the needs of an aging population, ranging from independent living in retirement communities to 24-hour care facilities.
7. **Childcare**: Real estate that is leased out to childcare centre operators.
8. **Social housing**: Low-income or disability housing encompassing both apartments and single-story dwellings.

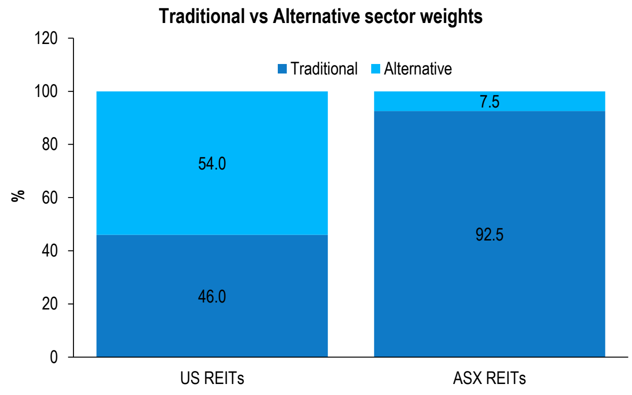
9. **Infrastructure REITs**: REITs that own properties that house infrastructure such as fibre cables, wireless infrastructure, telecommunications towers, and energy pipelines.

Note that several alternative property sectors such as data centres, student accommodation and infrastructure REITs, are increasingly blurring the lines between real estate and infrastructure as an increasing number of both real estate *and* infrastructure funds invest in these.

How big is the alternatives sector?

As a percentage of total US listed REIT market capitalisation, alternatives have expanded to comprise around 54%. This is substantially ahead the Australian market at only 7.5%.

Australia lagging in alternative REITs



Source: NAREIT, IRESS, MWM Research, October 2022

What is driving growth in ‘alternative’ sectors?

Growth in several alternative real estate is being primarily driven by long-term structural themes. This means this is a category of real estate that may be less sensitive to fluctuations in interest rates and/or cyclical forces:

1) The Digital Economy

The increasing digitisation of the world, often referred to as the ‘fourth industrial revolution” is creating ever increasing digital data storage needs, driving demand for **data centres**.

2) Demographics

An ageing population will drive increased demand for **medical office**, **life sciences** and **senior accommodation**.

3) Urbanisation

Increasing urbanisation is driving increased ‘densification’ of cities, which will see an increasing trend towards apartment living, providing an impetus for **build-to-rent** and **student accommodation** apartment complexes. Likewise, moving from large suburban to more compact urban living formats will support demand for **self-storage**.

4) Falling home ownership

Progressively worsening housing affordability has seen home ownership rates fall for successive age cohorts, suggesting an increased need for rental housing, which can be provided by **build-to-rent**.

5) Increased workforce participation

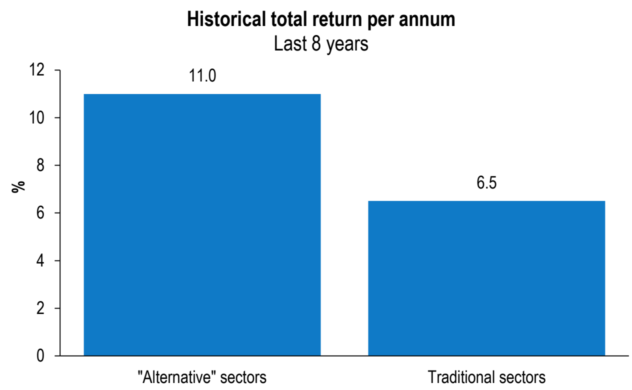
Increased workforce participation, particularly for females, will drive a corresponding increase in demand for **childcare** services. The sector has seen considerable government support in the form of childcare subsidies, the purpose of which is to encourage female workforce participation.

Why are ‘alternative’ sectors a useful addition to a portfolio?

As a source of returns

Alternative real estate has historically outperformed traditional real estate (+11.0% versus +6.5% per annum over the last 8 years) even given the inclusion of high performing industrial within the traditional category. The strong structural drivers underpinning demand for alternative real estate suggest continued potential for healthy returns especially against a backdrop where cap rate compression across traditional areas of real estate might not be a key driver for some time to come

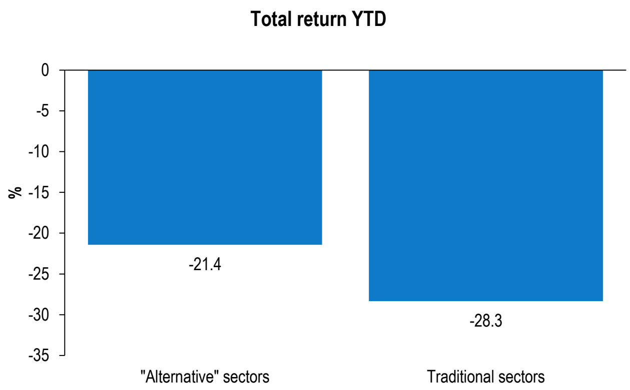
Alternative real estate has outperformed traditional over the long run



Source: Factset, MWM Research, October 2022

Alternative real estate has not only outperformed traditional over the longer term but has also demonstrated its resilience by outperforming during the year-to-date sharp selloff in listed real estate (-21.4% versus -28.3%).

Alternative real estate outperformed traditional during the recent selloff

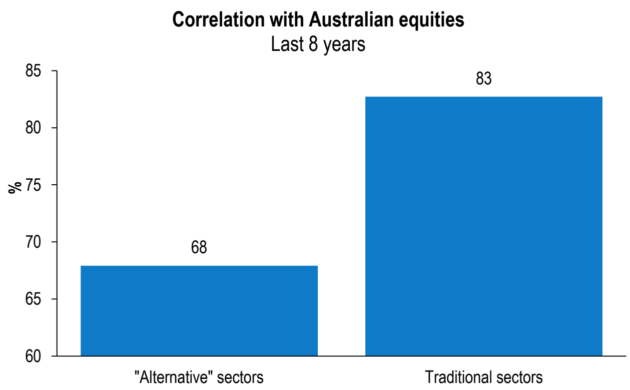


Source: Factset, MWM Research, October 2022

As a source of diversification

Alternative real estate is less correlated with broader equities than traditional real estate (68% correlation for alternatives versus 83% correlation for traditional) because many of these alternative areas are still in their early growth phase and because they are being supported by structural tailwinds. This means alternative real estate can potentially improve the risk-return profile of a balanced portfolio while also allowing those who might want to build deeper real estate exposures the luxury of having more investment options.

Alternative real estate sectors are less correlated with broader equities than their traditional counterparts



Source: Factset, MWM Research, October 2022

How do investors gain exposure to alternative sectors?

As with traditional real estate, alternative real estate can be invested via funds or listed stocks (i.e., REITs). In Australia, investment options are limited, and it remains hard to get pure exposure (other than via taking on individual direct asset risk).

We recommend a 5% weight to real assets within a balanced portfolio. There are very few ‘pure-play’ alternative real estate funds, so exposure has to be achieved via real estate funds that take overweight positions in alternative real estate.

Macquarie WM Investment Strategy Team

Investment Strategy Update #120 was finalised on 10 October 2022.

Recommendation definitions (Macquarie Australia/New Zealand)

Outperform – return >3% in excess of benchmark return

Neutral – return within 3% of benchmark return

Underperform – return >3% below benchmark return

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